



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

DIFFICULTIES AND DANGERS OF GOVERNMENT RATE-MAKING.

BY ALBERT S. BOLLES, LECTURER ON COMMERCIAL LAW AND
BANKING IN HAVERFORD COLLEGE.

No one will question the great part played by the railroads in the material development of the country. Without these agencies, transportation would have been limited to the slower methods of wagon and canal, and vast spaces which are to-day alive with human industry would still be in possession of bird and beast, the hunting-ground of the Indian.

Nor, again, will any one question that great evils have attended them. Personal greed, inexcusable inefficiency, unequal advantage, favoritism, too often have been the unexpected and unwelcome fruitage. Had these been private enterprises, their directors might have replied to all accusers: "The evils of which you complain are private matters, in which the injured only have any legitimate interest." Such an answer cannot be made by a railroad, because it is a public body, subject to public regulation and required to serve all on the same conditions. When, therefore, it departs from such a service, it violates its fundamental purpose, which it is the unquestioned duty of the State, if possible, to prevent. Consequently, in seeking to destroy rebate arrangements, smaller charges for long than for short hauls, and other manifest inequalities, the State is acting within its scope.

The Government, in attempting to correct these inequalities, has learned much, especially that rate-making is an exceedingly difficult problem. It is understood only by a few, even among the officials of a great transportation corporation; and the general public knows nothing save an occasional illustration. If many who are now so glibly advocating Government rate-making should read the testimony of Mr. Tuttle, President of the Boston and

Maine Railroad, before the Senate Committee, they would be greatly surprised at the complexity of the problem, and they would doubt the practicability of the proposed national procedure. They would clearly see that any quick and short-cut method of establishing rates would, doubtless, result in creating far more difficulties than those now existing. Indeed, the only correct method, we maintain, is the one which the larger companies for years have been pursuing, of simplifying the problem by combining roads, of making agreements they are willing to observe—in short, of removing the inequalities, and thus of benefiting themselves and the public, for both alike are, in the long run, if not always, interested in establishing and maintaining uniform rates. In fact, the railroads have already accomplished enough to justify the Government in continuing its present policy of non-interference, with the rational expectation that, ultimately, the railroads will solve the problem themselves.

In the well-meaning attempt of the Government, through the Interstate Commerce Commission, to lessen the inequalities mentioned, it has seemed to some persons, notably to the President, that the quicker and easier method of procedure by the Government is to regulate the rates; but this conclusion is founded on an altogether erroneous conception of the problem.

While the Government is attempting to correct inequalities by eliminating rebates, requiring merchandise to be transported as quickly for one shipper as for another—in short, by eliminating every kind of favoritism—the Government has a clearly definite standard to apply to every case. If a railroad carries A's grain from Chicago to New York in three days and requires three weeks to carry B's, unless a satisfactory reason is given for the delay, the Government can establish a clear case and enforce a remedy. In like manner, if rebates are given and discovered, there is no question about the wrong, and the guilty can be punished. But to make and establish rates is an undertaking radically different from that of discovering the rates given to shippers.

If the Commission is to make and establish rates, the Government ought to furnish it with some guide or measure. To endow this body with supreme authority, to commit the worth and prosperity of our great transportation enterprises to the determination of a few men, is an exercise of power which no Government with a desire to govern rationally ought to put forth.

At the outset, therefore, the Government should establish some kind of a standard. Suppose it should define a reasonable rate as one whereby a fair remuneration may be gained or expected on the capital invested; or, perhaps, a more concrete standard, that dividends should not exceed five, six, seven or other per cent. All, we think, will admit that investors ought to have fair return on their capital, save in some cases that will be hereafter considered. For, if they did not expect to receive such return, these enterprises would not have been undertaken.

What, then, is a fair return? The Government should answer this question for the Commission; or provide methods whereby that body could answer it. A very short penetration into this question reveals many difficulties in the way of finding the answer.

Let us assume that six per cent. would be an adequate return, and that this shall be the standard. An objector rises and says that half the capital invested is wind, and that by "capital" the Government meant money put into the enterprise by the stockholders. Suppose this to be admitted, and the Commission proceeds to find out and determinate the windy portion. The sum originally invested is easily ascertained, but that is only a part. Many of our railroads when first completed were in the crudest condition; more capital was added; for years no dividends were made and all the net earnings were employed to improve the road, stations, bridges, remove curves, lessen grades, acquire rolling-stock, and many other needful improvements. Surely all the money thus expended should be added to the capital in the Government's calculations.

Again, another railroad has made occasional dividends, one, two or three per cent., and all the rest of the earnings have been put into betterments. How much of the earnings in such a case may be properly added to the capital account? Consider the New York and Great Western. Organized a number of years ago, it has never yet declared a dividend on its common stock. It has been reorganized several times; numerous loans have been floated and turned into stock; preferred stock has been issued, also bogus stock; smaller lines have been bought and absorbed, sometimes at their cost, oftener at a much higher figure; every financial device conceivable has been practised by the company; and we question whether the most skilful expert could ascertain the amount of capital truly invested in that enterprise.

Again, one railroad leases another and the accounts have become blended; improvements have been made on both and charged without respect to the specific things done; perhaps it has not earned the money paid to the lessors; perhaps there is a surplus. How is the capital account of the leased line to be ascertained?

Then, there is a large series of railroads presenting an entirely different question. For years they did not pay; but the present owners, or their immediate predecessors, having faith in them, bought the stock for much less than the original price. Ought they to receive more than a fair return on the price they paid; or ought they to be rewarded on the original basis? This was one of the great questions in funding the American revolutionary debt. Much of it was purchased at a low figure, when the outlook for its redemption was very dark, the buyers incurred a great risk, but the world is never lacking in such adventurers. There were then three opinions concerning its redemption; one, that the present owners ought to be simply reimbursed with interest and the original owners ought to have the balance; the second, that the present owners should be reimbursed with interest, which should complete the redemption; the third, that the present owners should be paid the full amount. Each proposition is plausible. What would the Government Commission do in the numerous railroad cases involving the same question?

This question has another side. In some cases, railroads have been bought and sold or leased for more than their worth. Directors have taken advantage of their positions to make an undue profit for themselves. At what figure ought the lines thus purchased or leased to be capitalized for the purpose above mentioned? What rules shall Congress establish to guide the Government Commission in such cases? Surely its members ought not to be left to their own devices to find their way through the dark path that directors have unwittingly laid out for them.

Let us take one more series of railroads which are weighted with leased lines that do not earn their rental. Perhaps the lease can be defended on the ground that otherwise it would have been a competitor, and that a still larger sum would have been lost through competition. The fact nevertheless exists, and the value of the stock of the lessee is thereby unfavorably affected. Many of our larger railroads have numerous leases effected for a great variety of reasons that need not be described. But they

vitaly affect the prosperity and value of the property of the lessees in many ways. How is the true capital of such a railroad corporation for the purpose above mentioned to be ascertained?

Before the Government, through a Commission, attempts to establish reasonable rates, it should establish these two preliminaries. And, if the Government is honest and has an adequate comprehension of the question, it will do these two things. By no less a power than the Government itself should the great principle of remuneration be established, whether a reasonable rate, or a maximum rate per cent.; and then, through a Commission or other body, it should proceed to determine what is the just capital of every corporation on which dividends should be paid. Furthermore, Congress should aid the Commission in this work by setting forth the principles whereby they should proceed in determining the true capital of every road.

Assuming that these things will be done, we now approach the question, What is a reasonable rate in a particular case? A copper-ore shipper on the Southern Pacific appears before the Commission and declares that he is charged twice as much for the same distance as a competitor who luckily is located on the Denver and Rio Grande or Northern Pacific. "Surely," he says, "this is unreasonable, especially as there is hardly anything left for me in the way of profit." The railroad replies: "I admit everything you say, except your inference that the rate is excessive. If you have made but very little from your venture, the same thing is true of ourselves; we have managed our enterprise as economically as possible, and yet have never made a dividend. How, then, can you say that the rate is unreasonable? Furthermore, if we had never built the road, you would not have mined a pound of copper; our venture has made yours possible."

What reply can the shipper make? It may be that the railroad has earned something besides running expenses and the interest on its obligations. But every dollar has been spent in improving the physical structure, and millions more have been borrowed for the same purpose. The object of this expenditure, of course, is to bring the road ultimately to a paying condition. Meanwhile, all kinds of traffic share in the benefits of the improvements.

Again, is the lowest rate always a fair standard for competitors? Generally the railroad that is in the most favorable condition to fix low rates is a bankrupt concern, in the possession of a receiver.

If the receiver can make enough to pay running expenses, he can set the pace and keep it up until the end. He need not try to earn interest on the corporation's loans; as for the stockholders, they are entirely out of it. Such a railroad for many years was the New York and Erie; a menace to all solvent competitors, because it was insolvent and never expected to be any better.

The effect of a railroad's bankruptcy on its business future is just as different from that of a private individual's bankruptcy on his business future as can be imagined. If an individual fails, the competition he had previously waged against others ceases. When a railroad fails it is in the best possible condition to compete and underbid all rivals.

When, therefore, a shipper has demanded a lower rate because it was given by some other company, the truth often has been, as could be clearly proved if space permitted, that the unreasonable rate was that given by the lower-rate road. It is true from the shipper's point of view that he will suffer if the inequality is not corrected; and, if the Government is to do anything in the way of making reasonable rates, it should go much further than is proposed and prevent the making of unreasonably low ones.

Unreasonably low rates are made under three ordinary conditions: by bankrupt railroads; by railroads possessing an inferior service, poorer cars, longer time, slower delivery or other inferiority to their competitors; by railroads under peculiar conditions whereby a heavy cut is temporarily made to punish a rival or gain some advantage. Without going too far it would be difficult to justify the acts of those who have declared such rates on any occasion. Shippers ought to be willing to pay a fair rate on their merchandise, for it is only a charge that they pass on to the consumers. Whatever wrong is done by the practice of things for which there is no defence, the wrong is slight compared with the excessive and disastrous competition between different companies, which, we repeat, the Government, if attempting to do anything in the way of making rates, should prevent. Surely, it is quite as clear a duty of the Government to make a reasonable rate that will secure a fair return to stockholders, and thus insure the solvency of their companies, as to insure the solvency and prosperity of their shippers. Both have equal rights in law.

Let us now turn to another class of railroads on which dividends are made, one, two, or three per cent.; or, perhaps, on their

preferred stock and not on their common. Suppose the charge of unreasonable rate by such a railroad is presented to the Commission, would it contain any more truth than the charge first mentioned against the non-dividend-paying road? The stockholders are not adequately rewarded, and the management is economical. Can it be said that, in any of these cases, the rate is unreasonable? Of course, we are leaving out of consideration unequal rates.

For twenty years the railroads have been trying, by various arrangements, to make and maintain reasonable rates, but the Government has set its face like a flint against them for trying to do these things; and now it turns on them and says: "As you have not made and maintained reasonable rates between competing lines, we will do this for you." The Government proposes to do what the railroads would have accomplished long ago, had they not been deprived of their liberty of action.

Now let us turn to some of the larger railroads, like the Pennsylvania or New York Central, that render full compensation to their stockholders. All of them have numerous branches built with the view of extending their traffic, rendering their systems more complete and ultimately, if not immediately, becoming a source of profit. But in the beginning they do not pay.

Is the truth not evident that a higher rate for transporting on these branches would be reasonable than on the main line? And, if one rate is made for the entire service, as is often done, surely it must be a higher rate than for corresponding service on the main line. But how much higher? How would a Commission determine the question? Consider the numberless questions of this kind that might be presented by shippers, for these branches represent every condition of earning power. Some of them are conducted at a heavy loss; others pay something, others pay more, others are quite profitable. Just imagine a Government Commission facing this set of questions, in circumstances in which a company is trying to deal considerately with its patrons, but does not fully know itself what it ought to do, and the rate is regarded as a tentative arrangement subject to change as soon as both parties have a better knowledge of its effect. Is a railroad Commission justified in assuming that it is wiser than the parties, and that a better rule can be evolved by a body of men not a whit more intent on doing justly, and surely not possessing the experience of the railroad-traffic officers?

We now approach a very difficult class of cases, reserved at the outset, the various cases of invested capital, in which one may rightly question whether any return at all ought to accrue to the stockholders—indeed, whether the companies have any right to exist. We mean, of course, the parallel railroads, which, like some of the sugar refineries, were built not to be operated, but to be sold. Various practical suppositions can be made concerning these ventures. Let us take the case of the West Shore, for example. There was no justification for building it as a public need, for it tapped no new territory, it accommodated no one a whit better than the New York Central. But it began to do business, and for a time it did business. The business of the Central was drained away so rapidly that its net profits disappeared. The directors determined to pass the regular dividend, for none had been earned. Then the startling discovery was made that, if the road passed the dividend, many institutions which held its bonds would be obliged to sell them forthwith, because the law forbade them retaining as investments the bonds of non-dividend-paying roads. To prevent the inevitable sacrifice resulting from the offer of so many securities for immediate sale, a dividend of one-half of one per cent. was declared, and paid with money borrowed from two or three institutions holding its own bonds. Suppose the Central had cut the rate to meet its competitor, would that have been effective? Assuredly not; bankruptcy, if long continued, would have been inevitable. What would our Government Commission, if in existence, have done? Under the proposed law, nothing, and a road conceived in fraud would have been allowed to destroy one of the great systems of our country.

The wrong was done in permitting the parallel line to be built. Such action has often been taken, on the erroneous idea that competition in transportation is quite as good a thing as competition in production. But the conditions are so different that this is rarely true. To establish and maintain a low rate, a railroad needs much business; to multiply railroads for the same amount of business is to enhance the difficulty of carrying at a low rate. The West Shore was built to sell, and the only remedy was for its competitor to purchase. To save itself from bankruptcy the Central was obliged to incur a heavy obligation against its will; and to earn and make a lower dividend than before it was needful to raise the rates. Was the increase under these conditions justi-

fied? Why not? The public, which ought to have protected the Central from this piratical enterprise, did nothing, but rather looked on with glee at the prospective spoliation. The Central could not enjoin the other; it pursued the only practicable course, got its enemy out of the way by purchase. What would the Government Commission have done had a shipper complained to them of the advance in rates?

This is the history of many of these parallel ventures; they ought not to have been built, and as independent enterprises are not entitled to the public protection or regard. Conceived in fraud, they are usually managed in the same spirit; and, if solvent competing lines buy them to save themselves from ruin, are they to be blamed for making the public pay for its original dereliction of duty? The railroads that have thus been built to sell aggregate thousands of miles. What, we repeat, is a reasonable rate to charge in order to gain some return on the capital unwillingly invested under those conditions? And how does the Government propose, if regulating future rates, to guard existing companies against these unwelcome contingencies? Does it propose to suffer such adventurers to continue their work, and, when at last they are put out of the way at a heavy price, to prevent purchasers from making any advance to cover their unwilling action? If this should be the Government's policy, the ruin of the strongest railroad in the United States could be easily accomplished.

We now see clearly that reasonable rates have two very different meanings. By one meaning, the rate applies to a railroad and its shippers without any direct reference to the rate of a competing railroad. Is the rate, for example, unreasonable on a railroad that is essentially free from competition? The test to apply in such a case is the profit received by the stockholders. Is the profit unreasonable? By the other meaning, the rate applies to a railroad that competes with another railroad. Is the same test to be applied to determine the reasonableness of the rate? That is not the popular conception of the true method of determining the question. But if this is a proper test to apply in the first case, why is it not in the other? But the shipper says, "If something is not done, I may be ruined." And his fear may be grounded in reason. Is not the obvious remedy to correct the lower, unjustifiable rate—precisely what the railroads have been

trying to do, and would long ago have done if not prevented by the Government?

One more class of cases may be noted. A railroad pays no dividend for many years; at last its business has developed and dividend-paying begins. Are not the stockholders entitled to larger dividends, for a period at least, than the stockholders of a company that paid fairly from the beginning? A very small number of railroads have paid from the beginning; most of them have not paid until after years of waiting. In every other kind of business, the fat profits of the prosperous years are often justified because of the lean profits of the hard uncertain years. Is not this principle as clearly entitled to recognition in rewarding the owners of transportation enterprises as of those engaged in other pursuits? What would the Government Commission do in dealing with rates in this large class of cases?

But there are other aspects of this question worthy of consideration. If the Interstate Commerce Commission errs, its decision is subject to judicial review and correction. The right of appeal strongly tends to prevent many of the abuses that might arise if none were allowed. The purity and fair-mindedness of the courts are preserved in the same manner, by appeal and review, and finally by impeachment and removal for the greater misdeeds. But now it is jauntily proposed to establish a tribunal without a parallel in our history; one wholly alien to every conception of rational government; a tribunal from which there shall be no appeal to the highest federal court, but only to a "court of commerce," composed of five federal judges, "three of whom shall constitute a quorum." By existing law, the decisions of the Interstate Commerce Commission are reviewable by the Supreme Court of the United States; by the proposed law, decisions of far greater importance cannot be thus reviewed. What respect could one have for a reversal by the proposed court of commerce, consisting, as the court may, of three judges, two in favor of reversing, against one in favor of affirming, a unanimous decision by the Commission composed of five men, presumably possessing as much ability as the members of the court of review? This withholding of review from the Supreme Court is justified, forsooth, on the ground that the Commission will be a parental, kindly body doing equity between all. But, seeing the infirmity of all human institutions, what reason have we to sup-

pose that its course will be so much better than any predecessor? On the contrary, endowed with power so extraordinary, we have many reasons to suppose it will be worse. The temptations to do evil will be far greater than have ever confronted men in any other public position. The Commission will have political and personal proclivities, do what you will. The party in power appointing its members will make no mistake in selecting a majority from its own body. No one doubts for a moment that, if the Government owned all the railroads, or the principal lines, their wealth and power would be utilized by the party in power to strengthen its hold and continue its control. To transport the mails is just as much of a business as to transport freight and passengers, and yet the service has been a partisan service from the beginning, and is likely to be for an indefinite period.

Every one knows the part the railroads have played in State politics from the Atlantic to the Pacific. They cannot escape if they would. Strong as are the largest corporations in some respects, in other respects they are most vulnerable. And the larger they are, the greater are the dangers that surround them. No one understands their weaker positions better than politicians. The creation of commissions to examine or regulate them; the imposition of unreasonable expenditures for moving freight and passengers, or for raising tracks and other changes in their physical structure, additional taxes,—these are some of the methods by which politicians and their followers can annoy and threaten railroads. Around almost every State Legislature is a body of men who are seeking to exploit the railroads for their personal profit, under the guise, perhaps, of the public good. The railroads must ever be on guard to watch and defeat their enemies. They seek to elect their friends to legislative bodies and defeat those intent on self and plunder. Most of the great railroad systems to-day wish little, if anything, in the way of legislation; their strongest wish is to be let alone. But this is what the legislatures will surely not do; and so, the railroads, against their will, are involved to a greater or less degree in State politics.

Create the proposed Commission, with power to establish rates, and the future of the railroad would be largely in their control. A Presidential election is approaching; and the railroads are asked to contribute to the party funds. They refuse to comply, or to

give as much as the party managers desire. Would a railroad dare decline, after receiving an intimation that it would be well to contribute more liberally? A railroad president in his anger refuses, says he belongs to the other party, or does not like the candidate or his methods. Forthwith, some shipper makes his complaint that he is paying an unreasonable rate. The president soon discovers that he is in a net, with only one way to get out; the desired contribution is given, the party beggar calls off the shipper, and the difficulty is over.

Will the railroads be kept out of national politics when a Commission, composed of a few men, has its firm grip on them with power to squeeze out of them contributions, or to influence the suffrages of their numerous employees? Create this Commission and the future of every Presidential election can be foretold.

And what shall be said of the probable action of such a Commission in seeking to secure for their brothers, cousins and dear friends snug berths in the railroad offices? Could any easier or more effective way be imagined of creating good fellowship between the railroads and the Commission?

Would this vast machinery of transportation, once in the firm grasp of the Government, through its appointed and controlled Commission, move so high above all party influences that no one need fear its opportunities and its power? Those who think thus, if thinking at all, are blind to the plainest teachings of our brief political history. Would not popular phrase be soon changed from "reasonable rates" to "political rates"? Would not control without ownership, for that is what Government rate-making means, give rise to a series of tremendous dangers and disquieting consequences that would outweigh many times the ills now endured?

Finally, what is the popular conception of this question? Simply this: If two railroads are in any sense competitors, and one is making a lower rate than the other, the Commission should forthwith compel the one maintaining the higher rate to come down to the other's level. The shipper paying the higher rate says, "The lower rate enjoyed by my competitor is ruinous to me," and doubtless he is right. But he never looks beyond his own narrow interest. He neither knows nor cares how the railroad may suffer if it attempts to conform to his wishes. He never discovers that the real wrong is done by the railroad carry-

ing at the lowest rate, and that the true remedy is to compel it to raise its rate—or, perhaps, for one to raise and the other to reduce, until they are at the same level.

In all this discussion from the popular side there is not the trace of a thought that it should be a function of the Government to raise the rate of a railroad, although it may be bankrupt and in a condition to bring every other competitor into bankruptcy if permitted to continue.

The thought that a railroad can carry, and often has carried, freight at too low a rate, for which there was no justification, is quite beyond the public comprehension. That millions of bushels of grain have been carried by the railroads for many a year from the West to the seaboard at a loss, is an incident over which only stockholders grieve. The dissimilarity between the conditions of two railroads traversing the same territory—the one solvent and seeking to preserve its responsibility to its stockholders, the other bankrupt, responsible to nobody except the court, and not caring a fig about rates or profits—is a fact, however palpable to the most ordinary shipper, that never brings to him a regret, but only a smile. Others may lose heavily, but this is no affair of his; his interests do not go beyond himself. What he wants are rates as low or lower than are given to competitors by other lines, not by evening up but by evening down, and his sole conception of Governmental action is the achievement of that purpose. If ever a great question was gazed at by a large portion of the public in the narrow light of personal interest it is this.

If the proposed action by the Government were based on a clearer apprehension of the difficulties, and with a manifest purpose to advance rates when too low as well as to reduce them when too high, in short, to protect stockholders as fully as their patrons, and permitted appeals to be made to the Supreme Court of the United States, not solely on the ground that the Commission might err, but that it is a power too great and dangerous to lodge in any body without appeal to the highest tribunal, then the proposal might be worth considering. Until this is done the shippers have quite as much reason to fear as the railroads that this well-meant attempt to serve them will prove a costly delusion.

ALBERT S. BOLLES.